R9050-3

Tax Foundation Vol. 34, No. 11 December 1990

Tax Features

Packwood and Kanaga Receive Distinguished Service Awards; Address Simplification and Fairness

"In 1986, we were driven by one overriding desire," Senator Bob Packwood told the Tax Foundation's 53rd annual dinner in New York December 5th. "We wanted people to make investments from an economic standpoint."

Senator Packwood's speech followed the Tax Foundation's presentation to him of its Distinguished Service Award for contributions in the public sector and to William S. Kanaga, former chairman of Arthur Young & Co. for contributions in the private sector.

Mr. Kanaga's speech included several pointed remarks about the increasing complexity of the tax code and the federal budget. "The budget process has deteriorated to such an extent that we are all the more thankful to the Tax Foundation for taking a broad, educational, and thoughtful approach to the problem."

Senator Packwood made it clear that he sees tax simplification as a trade-off for fairness. "I'll tell you how to make it simple. At

See Annual Dinner on page 3

Tax Foundation Co-Chairman James C. Miller III (L) presents Senator Bob Packwood the Distinguished Service Award for contributions in the public sector.

PRESIDENT'S MESSAGE

Foundation Enters 54th Year

Wayne Gable

The Foundation began 1990 with a survey of members' concerns in fiscal policy and built the year's programs around them. Simplicity, stability, and efficiency are the goals they set for tax policy, remote though they seem when one considers the current code. The Tax Foundation cannot steer the fiscal policy of government, but we can help keep those goals in sight.

Three special events which futhered these goals during the year also helped to keep our members in touch with Washington policymakers. A seminar on research and development tax policy in March featured the foremost congressional authority on the R&D tax credit, Rep. Beryl Anthony (D-AR). He addressed the nagging problem of the credit's annual expiration which prevents taxpayers from counting on the credit in their tax planning. This is one of many instances where the code's instability hurts the economy.

May's conference on tax and budget issues drove home the theme that the current level of taxation is higher than ever, both at the federal and state levels. More restraint on the spending side, not more tax revenue, is needed to reduce governmental deficits.

In September, as the media whipped up an anti-foreign frenzy, the Foundation held a seminar in which experts in international tax policy, including Representatives Hank Brown (R-CO) and Phil Crane (R-IL), debunked some of the myths about foreign investment. The Foundation's belief that there should be a free flow of goods and capital across borders was a major theme of the speakers.

Successful conferences were also held in Dallas and New York, and we will continue to bring the Foundation's message around the nation and even abroad during the coming year. But as long as Washington is the place where the bulk of America's tax dollars are sent and spent, the Foundation will be there to bring you the unvarnished facts and figures.

Tax Foundation

IN THIS ISSUE

Annual Dinner and Awards	1
President's Message	1
Sin Taxes	2
Annual Conference Wrap-Up	4
College Classroom Project	6
OBRA Revenue Provisions	6
Capital Gains Tax	7
Member Briefings	8

David L. Littmann

Sin Taxes Drive Up Federal Spending, Fail to Raise Predicted Revenue

For two reasons the tax package recently enacted in Washington must be viewed as self-serving, rather than in the national interest. First, many of the new taxes will cause the Consumer Price Index (CPI) to rise; yet Congress and nearly all other federal employees and their important constituents are effectively immunized against such price increases. Automatic cost-of-living adjustments (COLA) in their pay and benefits are expressly designed to offset CPI increases.

Second, raising taxes, rather than controlling spending, postpones the day of reckoning when spending priorities must be established. Thus, elected officials avoid decisions that might risk their jobs or pensions; yet, these are critical decisions that households and private businesses must make all the time to remain solvent and competitive.

Let's examine 1990's sin tax package in greater detail. After all, the revenue expected from the so-called "sin" and excise tax hikes alone exceeds $53 billion.

At first blush it might appear that only a few industries or individuals — those directly in harm's way — would suffer greatly from sin tax increases. But because items that now carry higher sin taxes are included in the U.S. Labor Department's monthly survey of prices, higher sin taxes and other excise taxes drive the CPI higher as well. Those whose wages and benefits are tied to the CPI by COLA clauses (e.g., government workers, retirees, social security recipients and veterans) are effectively exempted (partially or wholly) from the result of these tax increases.

The accompanying table examines the cumulative effect of legislated COLA increases since 1970 compared to annual percentage gains in U.S. per capita personal income. One dollar in 1970, bolstered by 20 COLA add-ons becomes worth $4.38 as of January 1991. These COLA boosts nearly equal the entire $4.84 nominal income gains realized during this period by the average American. To the extent the real incidence of sin and excise taxes is shifted to non-COLA'd workers and consumers, the tax code becomes less equitable and more highly skewed in favor of government employees and those receiving direct benefits from Washington.

In addition to the equity and ethical issues of sin and excise taxes, there is economic perversity as well. Some 30 percent of federal outlays — $400 billion — is tied to the CPI. Raising tobacco, alcohol, airplane, gasoline, and (extending) telephone taxes actually drives up federal spending. Looking only at the 5 cent per gallon hike in the gasoline tax, for example, it might appear that $5 billion per year would be generated for Uncle Sam's coffers. But that 5 cent hike translates into a 5 percent increase in the pre-Kuwait pump price of gasoline. "Motor fuels" gets a 3.3 percent weight in the CPI, so a 5 percent jump in gas prices translates into a 0.2 percentage point increase in CPI. Funneled through the federal government's COLA clauses, those 0.2 percentage points would add between $800 million and $1 billion to overall federal spending. Hikes in other sin taxes push the CPI higher still, causing higher COLAs and greatly reducing net revenue gains.

> ***"Raising tobacco, alcohol, airplane, gasoline, and (extending) telephone taxes actually drives up federal spending."***

Also, lawmakers have chosen to offset the regressive effects of higher excise taxes by granting low income people tax credits or lower income tax rates. Ironically, the true cost of the tax hikes will be greater than suggested by initial revenue estimates, but the net revenue to Uncle Sam will be less.

Typically, sin taxes fail to raise as much revenue as projected. For example, excise taxes on cigarettes were doubled in 1982. Revenue from tobacco taxes (99.1 percent of which comes from cigarettes) jumped as predicted at first, from $2.58 billion in FY1981 to $4.66 billion by FY1984. But as consumers cut back their cigarette use, and as the black market in untaxed cigarettes grew, tobacco revenues contracted. By FY1989, tobacco tax revenues had slumped to $4.29 billion. Simply put, excise taxes are not a reliable revenue raiser.

As many studies have shown, new tax revenues merely accelerate the growth rate of federal spending, making deficit reduction even more remote. How else could record revenue gains — averaging $63 billion annually over the longest peacetime expansion the U.S. has ever enjoyed coincide with worsening deficits? Washington continues to shelter its own budget sins by levying more sin taxes. In the process it is worsening the performance of the private sector and shifting tax burdens increasingly toward private sector employees and citizens who do not receive federal benefits.

COLA Increases vs. Percent Changes In U.S. Per Capita Personal Income

1969 - 1990e

Year	U.S. Per Capita Personal Income	Percentage Change	COLA
1969	$3,809		
1970	4,051	6.35%	15.0%
1971	4,296	6.05	10.0
1972	4,664	8.57	20.0
1973	5,181	11.08	.0
1974	5,644	8.94	11.0
1975	6,073	7.60	8.0
1976	6,651	9.52	6.4
1977	7,294	9.67	5.9
1978	8,136	11.54	6.5
1979	9,033	11.03	9.9
1980	9,919	9.81	14.3
1981	10,949	10.38	11.2
1982	11,480	4.85	7.4
1983	12,098	5.38	3.5
1984	13,114	8.40	3.5
1985	13,896	5.96	3.1
1986	14,596	5.04	1.3
1987	15,423	5.67	4.2
1988	16,513	7.07	4.0
1989	17,596	6.56	4.7
1990e	18,432	4.75	5.4

Sources: Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics.

David L. Littmann is first vice president and senior economist with Manufacturers National Bank of Detroit, a member of the Tax Foundation since 1948.

Senator Bob Packwood (R-OR), Distinguished Service Award recipient for contributions in the public sector.

Tax Foundation Co-Chairman James Q. Riordan (r.) presents William S. Kanaga the Distinguished Service Award for contributions in the private sector.

Senator Bob Packwood (L) chats with the Honorable Harry F. Byrd, Jr., a former recipient. In his remarks, Senator Packwood said that along with Senator Russell Long, Senator Byrd had taught him more than anybody in Washington.

Annual Dinner from page 1

about a 16 percent tax rate, if you tax fringe benefits at full value and social security at about 85 percent, we'd have a simple code. No deductions, of course, for charitable contributions to your university or hospital, no excess medical deductions, no state or local income tax deductions — a straight flat tax — 16 percent. . . . If you're a single mother of two working at Woolworths making $14,000 gross, you're going to pay

"In 1986, we were driven by one overriding desire. We wanted people to make investments from an economic standpoint."

— Senator Bob Packwood

$2,240 in taxes. Would that be fair? My hunch would be that most people in this room tonight would say that isn't fair."

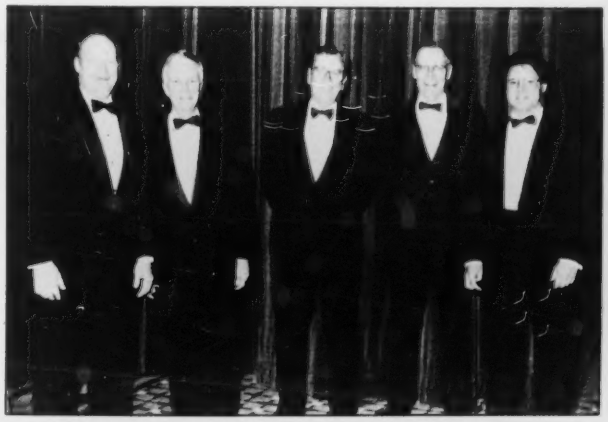
The senator addressed the subject of taxing the rich by first pointing out that no one considers himself to be rich. But taking $100,000 in annual income as a benchmark of wealth, the senator pointed out that no tax on this group can raise enough money to spare society at large the lion's share of the tax burden. "There simply aren't enough of them. . . . Today the top one percent of all the taxpayers in this country pay about $150 billion a year. That covers roughly the lower echelon of medicare programs, medicaid, food stamps — roughly the rich are paying for the poor."

The Oregon Republican closed with a more general consideration of fairness in taxation — just what percentage of a citizen's income

William S. Kanaga, former chairman of Arthur Young & Co. and recipient of the Distinguished Service Award for contributions in the private sector.

should be taxed, at the very most? He wants Americans to think about that issue because the overall portion of American taxpayers' income spent by government has steadily increased. "In 1950, total taxes, federal, state and local, equaled about 21 percent of GNP, and we spent about 23 percent of GNP — we had a deficit. Thirty-five years later, federal, state, and local taxes take about 30 percent of GNP, and we spend about 32 percent.

"The question is, do we want to become a nation like Denmark or Sweden which tax over 50 percent of GNP? As for me, I'd prefer to be America."



From left to right: James C. Miller III, co-chairman of the Tax Foundation; award recipients Senator Bob Packwood (R-OR) and William S. Kanaga; James Q. Riordan, co-chairman of the Tax Foundation; and Wayne Gable, president of the Tax Foundation.

Tax Foundation's 42nd Annual Conference Addresses Federal and State Budget Woes

The Tax Foundation held its 42nd annual conference in New York City the afternoon of December 5. Corporate executives, professors and students of economics and public finance, and members of the business press heard presentations from experts on the budgetary problems of federal and state government.

Federal Budget Ills

"The Ailing Federal Budget Process — Is There a Cure?" served as the theme of the first panel discussion. The subject was addressed first by Allen Schick, Professor of Public Policy, University of Maryland; and Alan Abramson, Research Associate, Urban Institute.

Alan Blinder, Gordon S. Rentschler Memorial Professor of Economics, Princeton University, moderated the panel and highlighted the complexity of the federal budget process in his introduction. "The budget process at the Federal level in this country is so complicated now that it looks like the tax forms that

Former Directors of the Office of Management and Budget: James McIntyre, Jr. (l.) served President Carter 1977-1980; James C. Miller III (r.), current co-chairman of the Tax Foundation, served President Reagan 1985-1988.

I have to fill out every April. There are actually nine different possible sequesters, and of course the same kind can occur more than once."

Allen Schick began by explaining, "What the budget summit and Gramm-Rudman III did is to change the thrust of Gramm-Rudman from control of the deficit to control of spending levels." Because the deficit can be adjusted due to IRS reestimates, S&L costs, Persian Gulf expenditures, and other factors without triggering a sequester, "it looks like the deficit has been defanged of its budgetary teeth."

An important political reason for our budgetary woes is 'divided government,' according to Schick. "Democrats have a lock on Congress, the Republicans on the White House. Divided government has become institutionalized and it turns out that one of the things that divides government between Democrats and Republicans is the budget itself. . . . Should it be any surprise that if the government is divided on the issue of the budget, that the humpty-dumpty of government cannot put itself together for a consistent course of action for deficit reduction."

"What we got in the 1990 budget deal was the largest tax increase in history, taxes that go on the books and that will remain there forever unless Congress takes them off."

— James C. Miller III

Alan Abramson of the Urban Institute followed Schick's remarks with views that were considerably more optimistic about the recent budget package and prospects for the new budget process's ability to control the deficit. "In contrast to some of the recent budget summit agreements, I think this year's package is longer on real deficit reduction and shorter on smoke and mirrors. A realistic projection, I think, would see the deficit, outside of the bail-out, shrinking from this year's three percent of GNP level down to one percent."

One definitely negative result Abramson noted was an echo of Blinder's introductory remark on the complexity of the budget process. "Under the new budget plan, we have 'discretionary caps,' 'pay-as-you-go' for entitlements and revenues, 'fire walls' around social security, 'look-back' procedures to guard against non-essential supplemental appropriations. . . . There is no constituency for making budgeting simpler, and the cost of having an incredibly complicated budget process is not only a bewildered public. The budget process is more open to gimmickry and manipulation by those who can exploit the loopholes that will inevitably be discovered."

Alan Abramson Research Associate Urban Institute

Blinder then introduced two former Directors of the Office of Management and Budget, James McIntyre, Jr., OMB Director for President Carter, 1977-80, and currently a partner in the McNair Law Firm in Washington, DC; and James C. Miller III, OMB Director for President Reagan, 1985-88, and currently chairman of Citizens for a Sound Economy and co-chairman of the Tax Foundation.

McIntyre opened with a salvo directed at Abramson and Schick who had both expressed their hopes for a falling deficit, but not necessarily a balanced budget. "I hear people say the deficit is not all that bad. Well, I will tell you, $327 billion dollars bothers me. As a budget director, sixty billion dollars bothered me. I was involved in the first summit in 1980, and we used a reconciliation process to try to get a $16.5 billion deficit down to zero. Now we are talking about $327 billion, and for the record, I think that is an unacceptably high level."

Allen Schick Prof. of Public Policy Univ. of Maryland

He went on to say that budgetary manipulations will never bring the deficit under control because the budget is a

political process. "When the deficit becomes a problem that gets enough people's attention, what do they do? They change the process. The fact of the matter is that only tough decisions made by our President and by our Congressmen will reduce the size of the national deficit."

James C. Miller III spoke next and issued his prognosis of the federal government's budgetary ills. "First, the federal government's command over resources is truly excessive. Second, our tax code, despite recent progress, is far more complicated and inhibiting of economic growth than it needs to be. Third, federal spending is not only growing at excessive rates, but the composition of that spending reflects the happenstance of the moment, not a well thought out establishment of priorities. Finally, there is our addiction to deficit finance."

The recent budget package would certainly not number among the cures Miller might recommend. "If anything, it made the situation worse because it will prolong the illness. What we got in the 1990 budget deal was the largest tax increase in history, taxes that go on the books and that will remain there forever unless Congress takes them off. Secondly, a gigantic increase in federal spending, over $100 billion in this 'year of austerity,' total spending goes up by over $100 billion, despite all the rhetoric about the cuts. And we have the promise of spending restraint in the out years. I say promise because I don't view the bonded enforcement package as workable."

Haskell Edelstein
Senior Vice President and General Tax Counsel
Citicorp/Citibank, N.A.

On Miller's list of remedies are some truth-in-budgeting reforms such as scrapping the current services budget and acknowledging all of government's financial liabilities in the budget. More specifically, in the defense area, Miller asserts there are some savings to be had, especially by more competitive procurement, multi-year budgeting, and, "preventing Congressmen's use of defense budget as fodder for their reelection campaign."

Among many concrete suggestions for cuts in federal spending, Miller included further means-testing on social security, eliminating the Interstate Commerce Commission, privatizing the U.S. Postal Service and cutting out the Amtrak subsidy.

State Budget Issues

"Significant Trends in State and Local Taxation" was the theme of the late afternoon panel. Haskell Edelstein, Senior Vice President and General Tax Counsel, Citicorp/Citibank, N.A., moderated the panel which included James W. Wetzler, Commissioner, New York Department of Revenue and Finance; Benjamin F. Miller, Counsel, Multistate Tax Affairs, California Franchise Tax Board; David Francis, Business Editor, *Christian Science Monitor*; and Thomas B. Joyce, Partner, Washington National Tax Services, Price Waterhouse.

James Wetzler conveyed the concern over keeping states' taxation in balance with its services. "Any state whose taxes greatly exceed the services that are being provided faces the risk that individuals and businesses are going to pick up and go somewhere else. His presentation explained how New York's franchise tax tends to have very volatile revenue yields. Unfortunately, with revenue volatility, when you get more revenue, the governor or the legislature tend to spend it. Once those spending programs are in place, they are hard to reduce when the volatility surfaces and the revenues decline."

Benjamin F. Miller
Counsel, Multistate Tax Affairs
California Franchise Tax Board

Benjamin Miller explained that state tax policies are becoming even more complex. Tax policies are not set just by the legislature or the governor or even by the tax boards. Now, tax policy is to a large extent influenced by court decisions.

David Francis predicted that the budget crisis in Massachusetts is not likely to go away very soon with spending still growing much faster than revenues. He suggested that the state's budget deficit situation is not too different from the federal government's predicament by comparing the state's constitutional requirement for a balanced budget with the federal government's Gramm-Rudman deficit reduction law. Unfortunately, both state and federal revenues have been overestimated while spending growth has gone unchecked.

Thomas B. Joyce
Partner, Washington National Tax Services
Price Waterhouse

See Annual Conference on page 8

The generosity of the following firms made our annual conference and dinner possible.

Aluminum Company of America
American Brands, Inc.
Arthur Andersen & Co.
The Blackstone Group
Burlington Northern Railroad Company
Campbell Soup Company
The Chase Manhattan Bank, N.A.
Chemical Banking Corporation
Citicorp/Citibank, N.A.
Coopers & Lybrand
Discount Corporation of New York
Cravath, Swaine & Moore
Ernst & Young
Exxon Corporation
Goldman, Sachs & Co.
Household International
Manufacturers Hanover Trust Company
Metropolitan Life Insurance Company
Mobil Corporation
Morgan Guaranty Trust Company of New York
Morgan Stanley Group, Inc.
Occidental Petroleum Corporation
Philip Morris U.S.A.
Price Waterhouse
The Procter & Gamble Company
Salomon Brothers, Inc.
Shearson Lehman Brothers
Shell Oil Company
The Southern Company
Sullivan & Cromwell
Tenneco Inc.
Texaco Inc.
Toyota Motor Sales, U.S.A., Inc.
USX Corporation
Wachtell, Lipton, Rosen & Katz
Xerox Corporation

College Classroom Project Continues to Bridge Gap Between School and Business World

The Tax Foundation gives advanced students of business, accounting, economics, and finance a glimpse of American business's concern with taxation by treating them to the annual conference in New York City as part of the "College Classroom Project."

Reports from the over 75 students were uniformly positive as they mingled with senior executives from companies they hope to find employment with in the near future.

The generosity of the following companies enabled more students than ever to participate in this year's project:

American President Companies, Ltd.
AT&T
Brooklyn Union Gas Company
Cantor Fitzgerald Securities Corp.
Chevron Corporation
Hallmark Cards, Inc.
International Minerals and Chemical Corporation
Johnson & Johnson
Masco Building Products Corporation
Merck & Co., Inc.
Monsanto Company
Norfolk Shipbuilding & Drydock Corp.
Occidental Petroleum Corporation
P.H. Glatfelter Co.
Philadelphia National Bank
UNUM Corporation
Weyerhaeuser Company
World Publishing Company

Dan Witt, vice president of the Tax Foundation at left, and Michael Ambler, General Tax Counsel, Texaco at right, pose with two students attending the conference.

Cadets from SUNY Maritime are joined by Gwain Gillespie, Executive Vice President - Finance & Administration, UNUM Corporation.

Summary of Revenue-Raising Provisions of H.R. 5835 (OBRA'90)

Tax Provision	Effective Date	Revenue FY1991-95 ($Millions)
Income/Employment Taxes		
1. Eliminate 33% "bubble" rate for individual income tax; replace with 31% marginal rate for all income above previous "bubble" threshold; maximum tax on capital gains 28%.	1/1/91	$11,234
2. Phase out personal exemption on adjusted gross income (AGI) above $100,000 - single; $125,000 - head of household; $150,000 - married (joint).	1/1/91	$10,764
3. Limit itemized deductions on AGI over $100,000	1/1/91	$17,904
4. Eliminate medical deduction for cosmetic surgery.	1/1/91	$269
5. Extend Social Security payroll tax to State/Local employees without employer pension plan.	7/1/91	$9,187
6. Increase Medicare payroll tax cap to $125,000.	1/1/91	$26,881
Excise Taxes		
1. Increase motor fuels excise taxes.	12/1/90	$25,039
2. Double "gas guzzler" tax.	1/1/91	$385
3. Increase tobacco taxes in 1991 and 1993.	1/1/91	$5,876
4. Increase alcohol excise taxes.	1/1/91	$8,768
5. Impose 10% tax on autos, boats, airplanes and other luxury items.	1/1/91	$1,479
6. Extend Leaking Underground Storage Tank (LUST) tax.	12/1/90	$594
7. Increase/extend Airport Trust Fund Excise taxes.	12/1/90	$11,908
8. Extend Federal telephone excise tax.	1/1/91	$13,069
Business/Miscellaneous Taxes		
1. Revise treatment of insurance company losses and salvage values.	1/1/90	$581
2. Require insurance companies to amortize deferred acquisition costs.	9/30/90	$7,995
3. Various tax compliance provisions.	3/20/90	$298
4. Increase reversion tax on retiree health reversions.*		$949
5. Raise interest rate on corporate tax underpayments.	1/1/91	$1,826
6. Expand ozone-depleting chemicals tax.*	1/1/91	$485
7. Increase Harbor Maintenance tax.*	1/1/91	$1,842
8. Other corporate tax provisions.	10/10/90	$1,342
9. Extend IRS fees for issuing private tax opinions.	9/30/90	$225
10. Extend Federal unemployment .2% surtax.	1/1/91	$5,396
11. Extend IRS collection limitation from 6 to 10 years.	1/1/91	$8
12. Revise treatment of U.S. beneficiaries of foreign trusts.		$297
Total Revenue-Raising Provisions		$164,600

*Treated as business tax.

Leif H. Olsen

Capital Gains Tax: A Sales Tax on our Nation's Savings

If you tuned in to the evening news any time during the recent budget battle, you may have heard a member of Congress speak out against higher gasoline taxes. He may have said they were unfair and would hurt the economy. The gasoline tax is, of course, a sales tax.

Five minutes later you might have heard that same member of Congress speak in opposition to a lower capital gains tax because it would favor the rich and that was unfair. But the capital gains tax is also a sales tax, so why doesn't the same argument apply?

Capital is thought to be largely owned by the rich so that a reduction in the capital gains tax would favor only this group. On the contrary, a great many Americans own capital assets and realize capital gains through the sale of homes, investing the proceeds partly in a less costly home and partly in interest and dividend yielding assets. As a result, income tax revenues go up. It is true, of course, that capital ownership is concentrated among a relatively small number of Americans, and they are rich relative to most Americans. So what's wrong with taxing them to the limit? They account for few votes. That is exactly what many members of Congress say publicly, and it sells with a great many Americans.

Here's what is wrong with that reasoning. During the past year Americans have rejoiced over the removal of the Berlin Wall and the general collapse of centrally planned, communist economies in Eastern Europe and the Soviet Union. Americans look on these events as the victory of our economic system over those of communism.

The key distinction between these command economies and ours is that capital is owned by government in communist countries while in the U.S. it is privately owned. You might say that in the communist-socialist economies capital gains are taxed at a 100 percent rate, since they are simply not permitted.

"We should worry less about who owns the nation's savings and more about how well it is managed."

After all, since the capital was owned by "the people's government," presumably its management served the best interests of the people and not just the rich. That presumption was wrong: not only is their machinery and equipment obsolete and technology outdated, but the environment has been severely polluted. What should we conclude from this example? We should worry less about who owns the nation's savings and more about how well it is managed. As a 1985 Treasury Department study of the capital gains tax put it:

"In an economic system placing a high value on free choice and consumer sovereignty, blocking or impeding voluntary exchanges or limiting competition causes a loss of economic efficiency by preventing transactions from which both parties gain. In the absence of significant externalities, economic efficiency is reduced by disallowing such transactions or by imposing costs that make the price paid by buyers differ from the price received by sellers."

That is exactly what the capital gains tax does. Since virtually all capital gains are reinvested in another asset, the seller is left with less to invest, build businesses, and create jobs. It doesn't help the tax base either because less investment means less income to be taxed.

The higher the tax, the greater the hindrance to individual choice. The Congressional Budget Office said in 1988: "The statistical results offer additional support for the view that higher tax rates do lower realizations of capital gains. As a result, increases in tax rates on capital gains produce much less revenue than they would if taxpayers' behavior were unaffected." This tells us that people make a conscious decision to immobilize their savings because of that tax. There are other unanswered questions. If capital management decisions are interfered with by the capital gains tax, what does this do to the accumulation of savings and the increase in wealth? What does it do to the growth of income over time which feeds the income tax revenues of the federal government?

"The more efficiently the nation's privately owned capital is managed, the stronger is the income tax base, through employment, growth and income on all levels."

The issue of "fairness" creates illusions. It implies that wealthy people buy a richer lifestyle through capital gains, taxed at a lower rate than income. That is not true. People do not typically live off a stream of capital gains. But if their management decisions are not distorted by capital gains taxes, they will cause their capital to grow in value and to generate more income in time. That income is taxed at a progressively higher rate. In fact, the more efficiently the nation's privately owned capital is managed, the stronger is the income tax base, through employment, growth and income on all levels.

Americans acknowledge that our market economy with privately owned capital is superior to that of communism. Yet we contradict that acknowledgment with political rhetoric. People who own or manage capital, those who have become rich creating jobs, or in entertaining people in sports and the theater, are forced to defend their economic legitimacy in a political system that presumably extols private ownership of capital. They are treated derisively and with hostility in public political debate. Our political system has and will continue to manage that contradiction. But when it is translated into public policy, we should all ask whether we are being led to play a damaging game with the nation's privately owned savings. Are we all going to be poorer in the long run as our economy fails to perform as well as it could?

Leif H. Olsen, former chief economist for Citibank, now heads Leif H. Olsen Investments, Inc. in New Canaan, Connecticut.

Annual Conference from page 5

Thomas Joyce pointed out the similarities between state and international taxation. In both cases cross-border taxes are levied, involving separate governments with different, independent tax and spending authorities. The growing level of international trade and the rapidly changing federal international tax rules cannot help but impact states in their decision-making process. If the federal code allocates income away from a U.S. corporation subject to state tax, then the state loses that taxable pool of income as well.

For proceedings of the conference, please contact the Foundation.

Tax Features

Tax Features (ISSN 0883-1335) is published by the Tax Foundation which operates as a separate unit of Citizens for a Sound Economy Foundation. Original material is not copyrighted and may be reproduced. Please credit Tax Foundation.

Co-Chairman ..... James Q. Riordan
Co-Chairman ..... James C. Miller III
President ..... Wayne Gable
Vice President. ..... Dan Witt
Director of Fiscal Affairs ..... Paul G. Merski
Senior Fellow ..... B. Anthony Billings
Editor ..... William Ahern
Editorial Asst. ..... Gretchen Georgiadis

Tax Foundation
470 L'Enfant Plaza, S.W.
Suite 7112
Washington, D.C. 20024
202-863-5454

Foundation Briefs Connecticut Members

From left to right: Julianne Maggio, Director of Taxes, Finevest Foods, Inc.; Dan Witt, Vice President, Tax Foundation; Michael Ambler, General Tax Counsel, Texaco, Inc., James C. Miller III, Co-Chairman, Tax Foundation; Robert L. Plancher, Senior Vice President and Chief Accounting Officer, American Brands, Inc.; George B. Erensen, Vice President - Taxes, Olin Corp.; Frank J. Bianca, Vice President, Taxes, American Brands, Inc; and Wayne Gable, President, Tax Foundation.

From left: Tax Foundation President Wayne Gable; George B. Erensen, Vice President - Taxes, Olin Corp.; Frank J. Bianca, Vice President, Taxes, American Brands, Inc.; and Gerald K. Howard, General Tax Counsel, GTE Corp.

Tax Foundation Co-Chairman James C. Miller III (L) with Robert L. Plancher, Senior Vice Presidnt and Chief Accounting Officer, American Brands, Inc.

470 L'Enfant Plaza, S.W.
Suite 7112
Washington, DC 20024

Non-Profit Org.
U.S. Postage
PAID
Washington, DC
Permit No. 2979

Mr. Ed Kianka
Acquisitions Editor
4520 East-West Highway
Bethesda, MD 20814-3389